

Issue Paper Number 04-001



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- ☐ Board Meeting
- ☐ Business Taxes Committee
- ☐ Customer Services and
Administrative Efficiency
Committee
- ☐ Legislative Committee
- ☒ Property Tax Committee
- ☐ Other

REVISION OF PROPERTY TAX RULE 462.500

I. Issue

Should the Board authorize publication of revisions to Property Tax Rule 462.500, *Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings*, to clarify the definition of "comparability" and to add examples illustrating the categories of comparability?

II. Staff Recommendation

Staff recommends that the attached revised Property Tax Rule 462.500 be adopted and authorized for publication.

III. Other Alternative(s) Considered

None

IV. Background

BOARD'S RULEMAKING AUTHORITY. Under Government Code section 15606, subdivision (c), the Board is given the authority to prescribe rules and regulations to govern county assessors when assessing and local boards of equalization when equalizing. Government Code section 11340.6 prescribes a procedure for any interested person to petition a state agency requesting the adoption, amendment, or repeal of a regulation. In response, the state agency may exercise its rulemaking authority and take the requested action or it may deny the petition.

PROPERTY TAX RULE 462.500

Property Tax Rule 462.500 sets forth provisions to implement property tax relief for owners of real property acquired to replace property taken by governmental action or eminent domain proceedings. In general, the rule allows the factored base year value of the property taken to be transferred to "comparable" replacement property, provided certain conditions are met. Without such relief, owners of property taken under such circumstances would lose the benefit of Proposition 13 that they enjoyed prior to the taking or acquisition. Rule 462.500 implements and makes specific the statutory and constitutional authority for this relief. (See Revenue and Taxation Code section 68 and Article XIII A, section 2, paragraph (d).)

Existing Rule 462.500 limits relief to replacement property that is deemed similar to the property taken "in size, utility, and function." Specifically, two properties are defined to be similar in function if they are subject to similar governmental restrictions, such as zoning. As to the criteria of size and utility, the rule states that these two criteria are "interrelated and associated with value," then states that properties are deemed similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken (i.e., single-family residential and duplex, multi-family residential other than duplexes, commercial, industrial, agricultural, vacant, etc.). As to value, the rule deems properties "comparable" (and therefore eligible for relief) only to the extent that the full cash value of the replacement property does not exceed 120 percent of the award or purchase price paid for the property taken. The rule includes three examples illustrating the application of these criteria for "comparability."

Additionally, the existing rule sets forth a procedure for determining the appropriate "base year value" of a qualifying replacement property; describes ownership requirements that must be met before relief is granted; and states that the relief shall be granted only if a request is made within four years after one of three specified dates relating to the governmental action.

REQUEST FOR RULEMAKING. Pursuant to Government Code section 11340.6, Terry L. Polley of Ajalat, Polley & Ayoob has requested that the Board amend Property Tax Rule 462.500, *Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings*, to replace the existing requirements of subsection (c), "Comparability," with a reference to "like kind" property within the meaning of Internal Revenue Code section 1031 and the Treasury Regulations thereunder.

Mr. Polley believes that the reference to the income tax code and the whole body of law developed thereunder would simplify Rule 462.500. Under Mr. Polley's request, one existing aspect of subsection (c) that would be retained is the limitation of 120 percent of the award or purchase price paid for the replaced property. Mr. Polley advances the following reasons in support of his request:

FORMAL ISSUE PAPER

- (1) Internal Revenue Code section 1031 provides for the nonrecognition of gain or loss where there is an exchange of "like kind" property under certain circumstances. In the case of real estate, "like kind" is interpreted very broadly. For reasons peculiar to income taxes, section 1031 applies only if both properties in the exchange are either held for productive use in a trade or business or held for investment.
- (2) Internal Revenue Code section 1033 provides for the nonrecognition of gain or loss where there is an involuntary conversion of property under certain circumstances. There are a number of types of transactions that constitute involuntary conversions, including the destruction and theft of property. However, section 1033(g) contains a special rule for involuntary conversions that result from condemnation and refers back to section 1031 which provides for a broad definition of like kind property.

The Board held two interested parties meetings on this petition. At the first interested parties meeting, county representatives opposed the petition by Mr. Terry L. Polley, but there was general agreement that the petition identified several issues with respect to the current rule that should be addressed and clarified. It was generally agreed that the language in the Constitution and statute is vague and that existing guidance is limited. More specifically, the meaning of the terms "size, function, and utility" as the requirements for comparability of the replacement property were discussed and the participants indicated an interest in finding a middle ground to resolve the issues. Staff reviewed all legal opinions issued by the Board that involved the comparability issue and summarized the results in a matrix which was mailed to interested parties. As a result of the assistance and feedback of the participants, staff drafted changes to Rule 462.500 and mailed those changes to interested parties. These changes were further edited at the second interested parties meeting. *The attached revisions to the rule contain language agreed upon by interested parties who participated.*

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that the attached revisions to Property Tax Rule 462.500 be authorized for publication. The draft identifies staff's recommended changes arrayed in a strikeout-and-underline format. The proposed revisions to the rule contain language agreed upon by interested parties who participated in the project.

Noteworthy changes to the rule include:

1. Addition of clarifying definitions for "displaced," "real property," and "adjusted base year value."
2. Amendment of the definition of "comparability" to provide that size is associated with value, not physical characteristics; that function and utility are associated with use; and the delineation of three categories of use:
 Category A – single family residence or duplex
 Category B – commercial, investment, income, or vacant property
 Category C – agricultural property.
3. Addition of examples to illustrate the new categories of function and utility.
4. Addition of clarifying language and an example regarding the base year value that is to be transferred.
5. Addition of a fourth date after which a replacement property must be acquired.

B. Pros of the Staff Recommendation

Redefining "comparability" based on property usage rather than property type will simplify the application of the property tax relief and, in addition to the other clarifying changes, establish a more uniform treatment for taxpayers whose property has been taken or acquired by a governmental entity.

C. Cons of the Staff Recommendation

None

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Title 18 of the California Code of Regulations, Chapter 1, Subchapter 4, section 462.500.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.

2. Revenue Impact

None

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

None

VI. Alternative 1

A. Description of the Alternative

Not applicable

Prepared by: Property and Special Taxes Department, Assessment Policy and Standards Division;
Legal Department, Property Taxes Section

Current as of: March 18, 2004

Rule 462.500. CHANGE IN OWNERSHIP OF REAL PROPERTY ACQUIRED TO REPLACE PROPERTY TAKEN BY GOVERNMENTAL ACTION OR EMINENT DOMAIN PROCEEDINGS.

Authority Cited: Section 15606, Government Code.

References: Article XIII A, Section 2(d), California Constitution.
Section 68, Revenue and Taxation Code.
~~Article XIII A, Section 2(d), California Constitution.~~

(a) GENERAL. The term "change in ownership" shall not include the acquisition of comparable real property as replacement for property taken if the person acquiring the replacement real property has been displaced from property in this state by:

(1) Eminent domain proceedings instituted by any entity authorized by statute to exercise the power of eminent domain, or

(2) Acquisition by a public entity, or

(3) Governmental action which has resulted in a judgment of inverse condemnation.

(b) DEFINITIONS. The following definitions govern the construction of the words or phrases used in this section.

(1) "Property taken" means ~~both real property taken and property or~~ real property taken as provided in (a).

~~(2) "Replaced property" means real property taken.~~

~~(32)~~ "Replacement property" means real property acquired to replace property taken.

~~(43)~~ "Award or purchase price" means the amount paid for "replaced property taken" but shall not include amounts paid for relocation assistance or any thing other than the replaced real property. The award or purchase price may not reflect full cash value.

(4) "Displaced" means a property owner is removed, expelled, or forced from property as a result of eminent domain proceedings, acquisition by a public entity in lieu of instituting eminent domain proceedings, or governmental action resulting in a judgment of inverse condemnation.

(5) "Real property" includes land, land improvements, living improvements, manufactured homes, and fixed machinery and equipment. Personal property is not entitled to relief under this section.

(6) "Adjusted base year value" means the base year value, as determined in accordance with Section 110.1, with the adjustments permitted by subdivision (b) of Section 2 of Article XIII A of the California Constitution and subdivision (f) of Section 110.1.

(c) COMPARABILITY. Replacement property, acquired by a person displaced under circumstances enumerated in (a), shall be deemed comparable to the ~~replaced property taken~~ replacement property if it is similar in size, utility, and function.

~~(1) Property is similar in function if the replacement property is subject to similar governmental restrictions, such as zoning.~~

~~(21) Both the The size and utility of property are interrelated and is associated with value, not physical characteristics. Property is similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken (i.e., single family residential and duplex, multi family residential other than duplexes, commercial, industrial, agricultural, vacant, etc.) and if its full cash value does not exceed 120 percent of the award or purchase price paid for the replaced property taken.~~

~~(A) A replacement property or any portion thereof used or intended to be used for a purpose substantially different than the use made of the replaced property, shall to the extent of the dissimilar use be considered not similar in utility.~~

~~(B) A replacement property or portion thereof which satisfies the use requirement but a replacement property, or portion thereof, that has a full cash value which exceeds 120 percent of the award or purchase price shall be considered, to the extent of the excess, not similar in utility and size.~~

(2) Property is similar in function and utility if the replacement property is or is intended to be used in the same manner as the property taken. Property is similar in function and utility if the property taken and the replacement property both fall into the same category:

Category A: Single family residence or duplex. Small miscellaneous buildings may be included when used with residence.

Category B: Commercial, investment, income, or vacant property. Single family residences and duplexes that are used as investment property may be considered income property if sufficient proof is provided to the assessor. Proof may include, but is not limited to, rental or lease agreements, cancelled checks, income tax returns, or other investment records.

If property does not fall within Category A or Category C, it falls within Category B.

Category C: Agricultural property. "Agriculture" includes farming in all its branches, and, among other things, includes the cultivation and tillage of the soil, dairying, the production, cultivation, growing, and harvesting of any agricultural or horticultural commodities, the raising of livestock, bees, furbearing animals, or poultry, and any practices (including any forestry or lumbering operations) performed incidental to or in conjunction with such farming operations, including preparation for market and delivery to storage or to market or to carriers for transportation to market.

Agricultural property that is in transition may be considered similar to property described in Category B if property in its vicinity has been changing from historically agricultural use to another use. Factors that may be considered to determine whether agricultural property is in transition include, but are not limited to:

- Restrictions that would prohibit the property taken from converting to property described in Category B such as the general plan, community plan, or special plan. Current zoning restrictions are not such a restriction if the general plan, community plan, or special plan contemplate a zoning change.
- The highest and best use of the property taken;
- The type of comparable property that was used by the acquiring government body to value the property taken.

(3) To the extent that replacement property, or any portion thereof, is not similar in function, size and utility, the property, or portion thereof, shall be considered to have undergone a change in ownership.

EXAMPLE 1: An owner-occupied single family residence ~~home~~ is replaced by a combination dwelling and commercial property. Relief is applicable to only the dwelling portion of the replacement property; the commercial portion shall be considered as having changed ownership.

EXAMPLE 2: A combination dwelling and commercial property is replaced with an owner-occupied single family residence ~~home~~. Only the dwelling portion of the property taken shall be

considered in determining the comparability and the amount of relief. The right to relief on the commercial portion of the property taken is waived unless ~~comparable~~ replacement Category B commercial property is acquired after the date of displacement and a timely request is made for assessment relief.

EXAMPLE 3: A combination dwelling and commercial property is replaced with a ~~home~~ Category A single family residence, and later the displaced person also acquires a separate comparable replacement ~~commercial~~ Category B property. ~~Pro~~ Pro-rata relief shall be granted on both the replacement ~~home~~ Category A single family residence and ~~commercial~~ Category B property to the extent provided in subdivision (b)(1).

EXAMPLE 4: An owner-occupied single family residence is replaced with an owner-occupied single family residence and a vacation home. Relief is applicable to both properties.

EXAMPLE 5: An owner-occupied single family residence that has a homeowners' exemption is replaced with a single family residence that is to be used as a rental property. The replacement property qualifies for relief because a Category A property is replaced by another Category A property.

EXAMPLE 6: A duplex in which the property owner lived in one unit and rented the other unit is replaced with two single family residences, one of which will be owner occupied. Relief is applicable to both properties.

EXAMPLE 7: Three single family residences that were owned by a taxpayer and used as rental properties were replaced by a small apartment complex. Relief is available under Category B if the taxpayer provides proof to the assessor that the single family residences were held as income property.

EXAMPLE 8: A taxpayer owns a 40-acre vineyard which includes an owner-occupied single family residence. The owner-occupied single family residence is taken along with 5 acres of grapevines. To qualify for relief, the owner-occupied single family residence should be replaced with Category A property; the vineyard should be replaced with other Category C property.

(d) BASE YEAR VALUE OF REPLACEMENT PROPERTY. The following procedure shall be used by the assessor in determining the appropriate adjusted base year value of comparable replacement property:

(1) Compare the award or purchase price paid by the acquiring entity for the property taken or acquired with the full cash value of the comparable replacement property.

(2) If the full cash value of the comparable replacement property does not exceed 120 percent of the award or purchase price of the property taken, then the adjusted base year value of the property taken shall become the replacement property's base year value, regardless of the allocation between land and improvements.

(3) If the full cash value of the replacement property exceeds 120 percent of the award or purchase price of the property taken, then the amount of the full cash value over 120 percent of the award or purchase price paid shall be added to the adjusted base year value of the property taken. The sum of these amounts shall become the replacement property's base year value.

(4) If the full cash value of the comparable replacement property is less than the adjusted base year value of the property taken, then that lower value shall become the replacement property's base year value.

(5) If there is no award or purchase price paid by the acquiring entity (i.e., an exchange) for the property taken, then the full cash value of the acquired property and the full cash value of the replacement property shall be determined by the assessor of the county in which each

property is located for the purpose of applying the other provisions of this subdivision. The procedure set forth in subdivision (d)(1) through (d)(4) shall then be applied to determine the replacement property's base year value.

(6) A base year value may be reallocated upon the transfer to the replacement property. The appraisal unit that is normally bought and sold in the market place may be used to determine the amount of base year value that is allocated to the property taken.

EXAMPLE 9: A commercial property, consisting of land and improvements, is taken and replaced with a Category B structure that was built on land that the taxpayer already owned. The land is ineligible for relief because it was previously owned. Despite the ineligibility of the land, the base year value of the property taken (land and improvements) may be transferred to the newly constructed improvements to the extent it meets the value and timing requirements.

(e) OWNERSHIP REQUIREMENTS. Only the owner or owners of the property taken, whether one or more individuals, partnerships, corporations, other legal entities, or a combination thereof, shall receive property tax relief under this section. Relief under this section shall be granted to an owner(s) of ~~replaced property taken who obtaining~~ obtains title to replacement property. The acquisition of an ownership interest in a legal entity which, directly or indirectly, owns real property is not an acquisition of comparable property.

EXAMPLE 10: ~~A & and~~ B each own an undivided 50% ~~percent~~ interest as joint tenants in a home which is taken through eminent domain proceedings by the state. A purchases a replacement ~~home~~ property which is comparable to the ~~replaced property taken~~. B contributes his share of the award or purchase price to a limited partnership which owns a home which is comparable replacement property. A's relief under this section is limited to 120 percent of one-half of the award or purchase price of the property taken. B is entitled to no relief.

EXAMPLE 11: A partnership composed of two corporations owns commercial property which is taken through eminent domain proceedings. The partnership uses the award or purchase price to acquire ~~comparable commercial~~ Category B property. The partnership is entitled to relief under this section.

EXAMPLE 12: A partnership composed of two corporations owns commercial property which is taken through eminent domain proceedings. The partnership distributes the award or purchase price to the partner corporations in the same percentage as their ownership interests and the corporations separately or jointly acquire comparable replacement property retaining the same percentage of ownership interest in the partnership. No tax relief may be granted under this section.

For purposes of this section, owner means the fee owner or life estate owner of the real property taken and excludes the lessee thereof unless the lessee owns improvements located on land owned by another, in which case, the lessee shall be entitled to property tax relief for comparable replacement improvements.

(f) NEW CONSTRUCTION. Any new construction required to make replacement property comparable to the property taken shall, to that extent, be eligible for property tax relief, if such new construction is ~~completed after March 1, 1975, and if it is completed on or after the earliest~~ of the dates listed in subdivision (g)(3), and if a timely request is made for assessment relief.

(g) TIME LIMITS FOR QUALIFICATION.

(1) The provisions of this section shall apply to property acquired ~~after March 1, 1975, as~~ replacement property for property taken ~~after March 1, 1975, by eminent domain proceedings, public acquisitions, or judgments of inverse condemnation, and shall affect only those assessments of the replacement property on the 1983-84 assessment roll and thereafter,~~

provided the person acquiring replacement property makes a timely request for such assessment with the assessor. The replacement property must be acquired before a request is made. No reassessments and no refunds shall be made for any years prior to the 1983-84 fiscal year because of decreases made to assessments for the 1983-84 fiscal year or fiscal years thereafter as a result of the provisions of this section. Reassessments and refunds shall be made retroactively to the date of acquisition of replacement property for property taken in fiscal years commencing with 1983-84, provided a timely request is made therefor.

(2) For purposes of this section, ~~a request made by January 1, 1987, shall be deemed timely for replacement property acquired after March 1, 1975, and before January 1, 1983. For replacement property acquired on or after January 1, 1983, a request shall be deemed timely if made within four years after one of the following dates, whichever is applicable:~~

(A) The date final order of condemnation is recorded or the date the taxpayer vacates the ~~replaced property~~ taken, whichever is later, for property acquired by eminent domain; ~~or~~

(B) The date of conveyance or the date the taxpayer vacates the ~~replaced property~~ taken, whichever is later, for property acquired by a public entity by purchase or exchange; or

(C) The date the judgment of inverse condemnation becomes final or the date the taxpayer vacates the ~~replaced property~~ taken, whichever is later, for property taken by inverse condemnation.

(3) Replacement property shall be eligible for property tax relief under this section if it is acquired ~~after March 1, 1975, and if it is acquired on or after the earliest of the following dates:~~

(A) The date the initial written offer is made for the ~~replaced property~~ taken by the acquiring entity;

(B) The date the acquiring entity takes final action to approve a project which results in an offer for or the acquisition of the ~~replaced property~~ taken; ~~or~~

(C) The date the 'Notice of Determination,' 'Notice of Exemption,' or similar notice, as required by the California Environmental Quality Act (CEQA), is recorded by the public entity acquiring the taxpayer's property and the public project has been approved; or

(D) The date, as declared by the court, that the ~~replaced property~~ was taken.

(4) No property tax relief shall be granted to replacement property, however, prior to the date of displacement. The date of displacement shall be the earliest of the following dates:

(A) The date the conveyance of the ~~replaced property~~ taken to the acquiring entity or the final order of condemnation is recorded;:

(B) The date of actual possession by the acquiring entity of the ~~replaced property~~ taken;:

or

(C) The date upon or after which the acquiring entity may take possession of the ~~replaced property~~ taken as authorized by an order for possession.

(h) ADMINISTRATION.

(1) The assessor shall ~~only consider any of~~ the following documents as proof of actual displacement of a taxpayer when a request has been made for the assessment relief provisions under this section:

(A) A certified recorded copy of the final order of condemnation, or, if the final order has not been issued, a certified recorded copy of the order for possession showing the effective date

upon or after which the acquiring entity is authorized to take possession of the ~~replaced~~ property taken;

(B) A copy of a recorded deed showing acquisition by a public entity; or

(C) A certified copy of a final judgment of inverse condemnation.

(2) Upon receipt of a taxpayer request and proof of actual displacement, the assessor shall forward to the Board such information regarding the identification of a displaced property as the Board may require. The Board shall review such information to determine whether more than one request for assessment relief has been made as a result of a single taking or governmental acquisition and if so shall advise the appropriate assessor(s).

History: Adopted September 13, 1984, effective February 16, 1985.
Amended November 18, 1987, effective February 14, 1988.



BOARD OF EQUALIZATION
REVENUE ESTIMATE

REVISION OF PROPERTY TAX RULE 462.500

Recommendation and Alternatives

Staff Recommendation:

Staff recommends that the revised Property Tax Rule 462.500 be adopted and authorized for publication.

Background, Methodology, and Assumptions

Staff Recommendation:

There is nothing in the proposed revision to Property Tax Rule 462.500 that would impact revenues. The amendments do not change the limit on the value of the replacement property. The amendments would change the criteria of utility and function from being based on zoning and property type to a definition that is based on usage. This change would expand the pool of properties from which to find a replacement property, but would not affect the limitations on the value of the replacement property.

Revenue Summary

The staff recommendation has no revenue effect.

Preparation

This revenue estimate was prepared by David E. Hayes, Research and Statistics Section, Legislative and Research Division. This revenue estimate was reviewed by Mr. Dean Kinnee, Chief of the Assessment Policy and Standards Division, Property and Special Taxes Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of March 17, 2004

cc: Mr. Dean Kinnee